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No. 06-1210

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IN THE

Supreme Court of the United States

GENERAL ELECTRIC COMPANY,
Petitioner,

v.

COMMISSIONER, NEW HAMPSHIRE
DEPARTMENT OF REVENUE ADMINISTRATION,
Respondent.

On Petition for a Writ of Certiorari to the Supreme Court of New Hampshire

REPLY BRIEF FOR PETITIONER

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RULE 29.6 STATEMENT

Petitioner has set forth its Rule 29.6 statement in its petition for certiorari filed *March* 2, 2007.

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REPLY BRIEF FOR PETITIONER

Respondent's Brief in Opposition pays scant attention to the central question here presented—whether the decision below can be reconciled with this Court's decision in *Fulton Corp.* v. *Faulkner*, 516 U.S. 325 (1996), and *Fulton's* state court progeny. Those cases all condemn as facially discriminatory tax deductions that are inextricably linked to the conduct of in-state business activity. Instead, respondent devotes most of his effort to defending an "aggregate" standard for determining tax discrimination that would look beyond the challenged tax to other taxes imposed on other taxpayers.

As we demonstrate below, respondent's failure seriously to address the conflicting decisions at the heart of this case is explained by the simple fact that the decisions are not reconcilable. Moreover, the "aggregate" standard on which respondent relies—a standard other courts have applied only when the discrimination at issue compares income streams

subject in one instance to combined reporting and in the other to separate reporting—has no role to play here because the State has excluded foreign subsidiaries from combined reporting and as a result has created a "separate" reporting environment for such entities. Finally, respondent's suggestion that this case is hypothetical and that GE has not been harmed is belied by his explicit recognition that GE would receive a dividends received deduction (DRD) if its foreign subsidiaries conducted income-generating business in New Hampshire and his agreement to pay GE its stipulated refund if GE prevails on the merits.

The repatriation of income from foreign subsidiaries is a significant aspect of U.S. multinational operations. No State should be allowed to tax in a discriminatory manner the dividends paid by such entities to their U.S. parent companies. This Court's review of the instant case is necessary to resolve the conflict that now exists among the state courts on the important question here presented.

I. THE DECISION BELOW CANNOT BE RECONCILED WITH *FULTON* AND ITS STATE COURT PROGENY

Fulton squarely holds that a tax deduction provided to a corporate shareholder based on the amount of activity the underlying corporation conducts in the taxing State facially discriminates against interstate commerce. To avoid the conclusion that New Hampshire's DRD similarly discriminates against foreign commerce, respondent suggests that *Fulton* is "not analogous" because the deduction allowed in calculating North Carolina's intangible property tax "was available against the stock of all corporations to the extent that their income was taxable in that state." Br. Opp. 17. New Hampshire's DRD is said to be different because it is "available only to parents of affiliates that own 80% of a subsidiary and only to the extent that the subsidiary had paid business tax on the same income distributed by the dividend." *Id.*

The 80% ownership requirement is a distinction without any constitutional significance. The fact that New Hampshire's discriminatory DRD is available to a more limited class of shareholders than was the case in *Fulton* is no defense to a claim of Commerce Clause discrimination. As this Court has declared, "[a]ctual discrimination, wherever it is found, is impermissible, and the magnitude and scope of the discrimination have no bearing on the determinative question whether the discrimination has occurred." *Associated Industries of Missouri* v. *Lohman*, 511 U.S. 641, 650 (1994). *See also Maryland* v. *Louisiana*, 451 U.S. 725, 760 (1981).

The fact that New Hampshire's DRD is available only to the extent the subsidiary has paid tax "on the same income distributed by the dividend" (Br. Opp. 17) is an equally invalid point of distinction. In fact, *Fulton* rejected a virtually identical argument. North Carolina defended its discriminatory tax deduction by asserting that the higher tax burden on shareholders owning stock in corporations doing less business in North Carolina compensated for the greater corporate income tax that corporations doing more business in North Carolina would pay to the State. See *Fulton*, 516 U.S. at 334. This Court dismissed the compensatory tax argument as "unconvincing." *Id.* at 335. Respondent's argument here is also unconvincing. To paraphrase this Court's conclusion in *Fulton*: "A regime that taxes [a dividend] only to the degree that its [paying] corporation participates in [foreign] commerce . . . tends, at least, to discourage [all] corporations from plying their trades in [foreign] commerce." *Id.* at 334.

Respondent's efforts to distinguish the state cases in direct conflict with the decision below are equally unpersuasive. Thus, respondent attempts to distinguish *D.D.I., Inc.* v. *North Dakota*, 657 N.W.2d 228 (N.D. 2003), first, on the same untenable ground on which it sought to distinguish *Fulton*, namely, that New Hampshire's discriminatory DRD "only applies to dividends from subsidiaries that own a minimum of

80% of the subsidiaries' stock," whereas North Dakota's DRD applied "regardless of stock ownership." Br. Opp. 21, 22.

Second, respondent purports to find a difference between *D.D.I.* and the instant case by asserting that New Hampshire's taxation of foreign dividends "is predicated upon the foreign subsidiary being part of the unitary business conducted in New Hampshire." *Id.* at 22. In the case of a nondomiciliary taxpayer (such as D.D.I. or GE), of course, a State may not apportion and tax dividends received unless they arise from a unitary business conducted by the taxpayer within the State. See p. 8, note 3, *infra*. The dividends North Dakota sought to tax in *D.D.I.* were held to be apportionable. They thus necessarily arose from the conduct of a unitary business in North Dakota, just as the dividends that New Hampshire is seeking to tax here arose from the conduct of GE's unitary business in New Hampshire.

Finally, respondent asserts that *D.D.I.* is inapposite because "it did not consider a dividend received deduction in the context of a water's edge combined reporting tax regime." Br. Opp. 22. This attempted distinction also misses the mark. Whether or not *D.D.I.* involved combined reporting, New Hampshire's water's edge combined reporting regime is, as explained more fully below, simply not relevant to its taxation of foreign subsidiary dividends.

Respondent next attempts to distinguish the discriminatory DRDs that California courts struck down in *Ceridian Corp.* v. *Franchise Tax Bd.*, 102 Cal. Rptr. 2d 611 (1st Dist. 2000); *Farmer Bros. Co.* v. *Franchise Tax Bd.*, 134 Cal. Rptr. 2d 390 (Ct. App. 2003), *cert. denied*, 540 U.S. 1178 (2004); and *General Motors Corp.* v. *Franchise Tax Bd.*, 16 Cal. Rptr. 3d 41 (2d Dist. 2004), *aff'd in part and rev'd in part on other grounds*, 47 Cal. Rptr. 3d 233 (Cal. 2006). This attempt further underscores the weakness of his case. Respondent asserts that the California cases are distinguishable because the DRDs at issue in those cases were limited to dividends

paid from California sources, whereas New Hampshire's DRD is allowed "regardless of the source of the income." Br. Opp. 22, 23, 24.

On this point, respondent is contradicted not only by his own statute and the interpretation given to it by the court below, *but also by his own Brief in Opposition*, which categorically states that the DRD is available "only to the extent that the subsidiary has paid business tax on the same income distributed by the dividend." Br. Opp. 17. Since a foreign subsidiary pays business tax only on income derived from New Hampshire sources, foreign subsidiary dividends eligible for a DRD in New Hampshire *must* have their source in New Hampshire.

In short, respondent's asserted points of distinction do nothing to negate the fact that the decision below stands in conflict with both *Fulton* and the decisions of the courts of North Dakota and California as well.

II. AN "AGGREGATE" STANDARD FOR DETERMINING DISCRIMINATION IS NOT APPROPRIATE IN THIS CASE

Respondent's defense of an "aggregate" standard for determining state tax discrimination here—a standard that looks to the "aggregate tax paid" (Br. Opp. 18) on the relevant incomes of both a parent and its subsidiary—rests squarely on a false analogy between the combined reporting regime that New Hampshire and other states provide for *domestic* members of a unitary group and the separate reporting regime that New Hampshire and other states provide for *foreign* subsidiaries.

Under a combined reporting regime, income of the group members is combined on a single return; intercompany transactions among group members (e.g., dividend payments) are disregarded; and the resulting income is apportioned to the taxing State. See Pet. 4. Under a separate reporting regime, by contrast, no income is combined. Each company files its

own return; transactions between companies (e.g., dividend payments) are respected; and each company's income is separately apportioned to the taxing State. See Pet. 7.

When, as in this case, a separate reporting company pays a dividend to a combined reporting company, the separate reporting rules apply, even though both companies may be engaged in a unitary business. In such a case, the dividend is respected and is reported as income of the combined group. Br. Opp. 8. The same result obtains when, as is also the case here, a dividend is paid by a foreign subsidiary not required to file a return with the State because it does no business there. (As previously noted, respondent fails to recognize that by excluding all foreign subsidiaries from the combined group, the State has created a separate reporting environment for such entities. They either file separately or not at all.)

In contrast to a case like this, in which dividend payments are made entirely in a separate reporting environment, claims of discrimination have also arisen when foreign subsidiaries filing separately (or not filing at all) pay dividends to a domestic member of a combined group. The basic contention is that the State discriminates against foreign commerce by taxing the foreign subsidiary dividends as income of the combined group, while disregarding the dividends paid by domestic subsidiaries within the group. In this context, *and only this context*, some courts have endorsed an "aggregate" standard for determining the existence of discrimination. They have compared the "aggregate tax" imposed on a combined group that includes a domestic subsidiary paying dividends with the "aggregate tax" imposed on a combined group with a foreign subsidiary paying dividends.

Every case that Respondent cites as authority for application of the "aggregate" approach to discrimination falls within the fact pattern just described.[1] *But that fact pattern has*

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[1] *Fujitsu IT Holdings, Inc. v. Franchise Tax Bd.*, 15 Cal. Rptr. 3d 473 (Cal. App. 2004) (sustaining tax on dividends from foreign payor because

nothing to do with the facts of this case. This case does not involve a claim of discrimination with respect to a foreign dividend payor filing separately and a domestic dividend payor included in the combined report. Rather, this case involves dividends paid by two classes of foreign subsidiaries that are not part of the combined group (Br. Opp. 5), one of which files a separate return (*id.* 9 n.7), the other of which files no return.

In the context of this case, there is no warrant for the "aggregate" approach espoused by respondent because there is no combined report involved, and, accordingly, nothing to aggregate.[2] Instead, the required approach here is the straightforward comparison of the relative tax burden on the two dividend streams under separate reporting. In the context of a separate reporting regime, every court—including this Court—has rejected the "aggregate" standard for determining the existence of discrimination.

As described in detail in the petition (Pet. 9-10, 17-19), this Court in *Kraft General Foods, Inc.* v. *Iowa Department of Revenue and Finance*, 505 U.S. 71 (1992), addressed an

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income of domestic dividend payor is included in tax base under combined report); *Bernard Egan & Co. v. State Dep't of Revenue*, 769 So. 2d 1060 (Fla. Dist. Ct. App. 2000), *rev. denied*, 790 So. 2d 1101 (Fla.), *cert. denied*, 534 U.S. 995 (2001) (same, under consolidated return); *Appeal of Morton Thiokol, Inc.*, 864 P.2d 1175 (Kan. 1993) (same, under combined report); *E.I. Dupont de Nemours & Co. v. State Tax Assessor*, 675 A.2d 82 (Me. 1996) (same, under combined report); *Caterpillar, Inc. v. Commissioner of Revenue*, 568 N.W.2d 695 (Minn. 1997), *cert. denied*, 522 U.S. 1112 (1998) (same for foreign interest and royalty payments, under combined report).

[2] Indeed, combined reporting is essentially irrelevant to this case, a point completely missed by the court below. GE would have had precisely the same claim as it is advancing here if it had filed a separate report in New Hampshire (as it would have done if it had only foreign subsidiaries) and had received dividends from its foreign subsidiaries, some of which did business and paid BPT in New Hampshire and some of which did not.

argument that in substance is identical to the argument respondent advances here. In *Kraft*, which involved Iowa's separate reporting regime, this Court observed that there arguably would be no discrimination "[i]f one were to compare the *aggregate* tax imposed by Iowa on a unitary business which included a subsidiary doing business throughout the United States (including Iowa) with the *aggregate* tax imposed by Iowa on a unitary business which included a foreign subsidiary doing business abroad," because "Iowa would tax an apportioned share of the domestic subsidiary's entire earnings, but would tax only the amount of the foreign subsidiary's earnings paid as a dividend to the parent." *Id.* at 80 n.23 (emphasis supplied).[3]

This Court then flatly rejected the "aggregate" approach in the context of a separate reporting regime like Iowa's, because in that context "the Iowa operations of the subsidiary provide an *independent* basis for taxation not present in the case of the foreign subsidiary." *Id.* (emphasis supplied). Accordingly, the appropriate approach in a separate reporting context, which is precisely the approach that GE has adopted here, is to evaluate the discrimination claim by focusing only

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[3] Part of the confusion surrounding footnote 23 may be attributable to some courts misreading this Court's reference to a "unitary business" as being an implicit reference to a combined report. Indeed, the court below committed this very error. See Pet. App. 15a (characterizing *Kraft* footnote 23 as "distinguishing between a single entity filing system . . . and a combined reporting method system"). In fact, this Court explicitly noted earlier in its opinion in *Kraft* that "Iowa is not a State that taxes an apportioned share of the entire income of a unitary business without regard for formal lines." *Id.* at 74 n.9. The discussion in footnote 23 must be read in that context. This Court's reference to the "unitary" aspect of the business in footnote 23 is no doubt explained by the fact that Kraft conducted a unitary business in Iowa and because Iowa lacked the constitutional power to include in the state's apportionable tax base any dividends received by a nondomiciliary corporation like Kraft unless they arose out of a unitary business conducted in the State. See *Mobil Oil Corp.* v. *Commissioner of Taxes*, 445 U.S. 425, 439 (1980).

on the taxation of the respective dividend streams, without "aggregating" the tax liability of both parent and subsidiary.

Subsequent to *Kraft*, state courts addressing allegations of discrimination in the treatment of dividends under separate reporting regimes have likewise rejected the "aggregate" standard. This is clear from the very cases respondent cites as recognizing—but *not* applying—the "aggregate" approach.[4]

In short, in a case such as this, involving two dividend streams and a separate return context, no court other than the court below has aggregated the tax paid by two separate entities (the dividend payor *and* the dividend recipient) in testing for discrimination.

III. GE HAS SUFFERED REAL HARM IN THIS CASE

Respondent's contention that this "Court should not review this case because Petitioner has not been harmed in any way," is Kafkaesque. Br. Opp. 24-25. Respondent's claim that GE's harm is "purely hypothetical" cannot be squared with its

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[4] *Hutchinson Technology, Inc. v. Commissioner of Revenue*, 698 N.W.2d 1 (Minn. 2005) (invalidating tax discrimination against foreign dividends under Commerce Clause based on a comparative analysis of the tax treatment of dividends paid under separate reporting regime without regard to any "aggregate" analysis of parent and subsidiary liability); *Conoco, Inc. v. Taxation and Revenue Department*, 931 P.2d 730 (N.M. 1996), *cert. denied*, 521 U.S. 1112 (1997) (invalidating tax discrimination against foreign dividends under Commerce Clause based on a comparative analysis of the tax treatment of dividends paid under separate reporting regime, and explicitly distinguishing cases involving combined reporting regimes which include a "portion of the domestic subsidiaries' income in the tax base of the parent"); *Emerson Elec. Co. v. Tracy*, 735 N.E. 2d 445 (Ohio 2000) (invalidating tax discrimination against foreign dividends under *Kraft* based on a comparative analysis of tax treatment of dividends paid under separate reporting regime and explicitly distinguishing combined reporting cases, noting that, with respect to subsidiaries under consideration, "Ohio's tax system does not differ from the single-entity reporting system involved in *Kraft*").

unqualified admission that "the Foreign Dividend Issue exists and applies to GE in each of the Tax Years," and that "[p]ursuant to the Settlement Agreements, the parties have agreed and stipulated that if the Foreign Dividend Issue is resolved in GE's favor, the Department will pay a refund to GE with respect to all of the Tax Years in the aggregate amount of $3,154,738." (See paragraph 11 of GE's complaint, Pet. 52a, and respondent's unqualified admission in its answer, Pet. 61a.)

In other words, the parties themselves have agreed that GE suffered real harm and have agreed on the precise value of GE's injury (the amount of the illegally collected tax) in the settlement agreements that preserved the issue of constitutionality of New Hampshire's DRD for litigation. See Pet. 2a.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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